

IRAN: THE STRUGGLE FOR A REVOLUTIONARY ISLAMIC ECONOMY

A Moslem's belief in the fundamentals of religion must be based upon reason and he may not practice imitation in regards to fundamentals of the religion, that is, accepting someone else's statement without reasoning. But in regards to the precepts (akham) of the religion he must either be an Expert (Mujtahed) and arrive at those precepts by reasoning or he imitates certainty from an Expert, that is, he acts according to his orders.

—Ayatollah Sayyed Ruhollah Mousavi Khomeini, *A Clarification of Questions*

Introduction

The Islamic Republic of Iran is to Islam what the Soviet Union was to communism, the fountainhead of the international revolutionary movement.¹ The 1979 Islamic revolution in Iran was the first overthrow of a modern secular leadership by a popular movement to establish a fundamentalist Islamic system. Its claim to universality inspires similar movements throughout the Islamic world. Furthermore it actively supports such movements with funding, including radical elements who have engaged in terrorist acts such as the Hezbollah in Lebanon.

Thus Iran stands out as an important example of practical Islamic economics, in which intense debates result in policy shifts by the revolutionary regime. Despite controversies, core elements of Islamic economics have been adopted, such as interest-free banking. Poor economic performance has weakened the appeal of the Iranian model to many observers. But supporters of the revolution point to external shocks, from invasion by Iraq, to an economic

¹To compare the 1917 Bolshevik revolution with the 1979 Islamic revolution in Iran see Richard W. Cottam, "The Iranian Revolution," in *Shi'ism and Social Protest*, eds. N. R. Keddie and J. R. I. Cole (New York: St. Martin's Press, 1986), pp. 121–58.

embargo by the United States, to a fall in world oil prices, sources of Iran's economic difficulties.

Despite its image as role model and revolutionary Islamic fountainhead, Iran is atypical of most Islamic nations. It is dominated by the Shi'i (Shi'ite), branch of Islam which differs from the more widespread Sunni branch. Shi'ism has traditionally been more revolutionary precisely because of its underdog position in the Islamic world relative to Sunnism. Some Sunni-dominated societies Islamizing their economies, such as Pakistan, have adopted more gradualist and less radical approaches. Nevertheless, the Iranian revolution influences radical Sunni movements in Algeria, Egypt, Palestine, Central Asia, and the fundamentalist Sunni government in Sudan.

Iran is a major oil producer and member of the Organization of Petroleum Exporting Countries (OPEC), which engineered the oil price shock of 1973.² At the time it was second to Saudi Arabia as a producer in OPEC and accumulated vast wealth, which triggered inflation and increased inequalities of income that fueled the revolutionary movement of 1979. Iran's importance in OPEC is clear because the second oil price shock in 1979 was not engineered by OPEC as a whole but resulted from the collapse of Iranian oil production during the revolution.

The Revolutionary Tradition in Shi'i Islam³

As recounted in Chapter 5 the Sunnis and Shi'is split over the succession to the Prophet Muhammed as leader of the Islamic community (*umma*). The Shi'is supported members of Muhammed's family, such as his son-in-law, Ali, and his grandson, Husayn, whereas the Sunnis supported nonfamily members for the political position of caliph. After the Shi'i defeat at the Battle of Karbala they developed the notion of a spiritual leader, the *Imam*,⁴ to be a direct descendent of Muhammed. The Imam *should* be caliph, but might not be. The Prophet's son-in-law, Ali, was both the fourth caliph and the first Imam. Husayn was the third Imam, succeeding his older brother.

The branch of Shi'ism dominant in Iran and most numerous worldwide recognizes a line of 12 such Imams and thus is known as Twelver Shi'ism.⁵

²Within OPEC, predominantly Muslim members are Algeria, Nigeria, Libya, Saudi Arabia, Iraq, Iran, Bahrain, Qatar, United Arab Emirates, and Indonesia. Venezuela and Gabon are non-Muslim members. Non-oil producing [there are oil-producing Muslim nations *not* in OPEC such as Oman, Egypt, and Yemen] nations with many Muslims include Bangladesh, India, Pakistan, and Turkey.

³For a history of Shi'i Islam see Moojan Momen, *An Introduction to Shi'i Islam: The History and Doctrines of Twelver Shi'ism* (New Haven: Yale University Press, 1985).

⁴In Sunni Islam an *imam* (not capitalized) leads Friday prayers at a mosque. This is distinct from the Shi'i *Imam* (capitalized) who is a supreme religious leader.

⁵The Zaydi Shi'is of Yemen agree on only the first four Imams. The Isma'ili Shi'is recognize the first seven and thus are known as Sevener Shi'is. The Seveners historically generated the most economically redistributionist Muslim movements and societies, such as the Oarmatians of Eastern Arabia in the 900s.

The Shi'i Imams could extend the prophecy of Muhammed, thus making Shi'i law codes subject to ongoing revision by religious authorities in contrast with Sunni ones.

When the 11th Imam died in 874 his infant son, the 12th Imam, went into hiding. For 70 years his proclamations were issued by four successive messengers. Then he was declared to have gone into a state of supernatural suspension (*Occultation*) wherein he waits hidden from the world until the Day of Judgment when he will return and bring about heaven on earth.

This doctrine underpins a messianic tradition in Twelver Shi'ism in which individuals periodically appear claiming to be either the Hidden Imam himself or his special messenger. The latter was the position of Ayatollah Ruhollah Khomeini, leader of Iran's Islamic revolution, although he was called *Imam* after the revolution.⁶ As supreme lawgiver he created and took the title *Vilayat al-faqih*, Mandate of the Jurist, a position held by Ayatollah Ali Khamene'i since Khomeini's death in 1989. No one is now called *Imam* in Iran.

Shi'i Islam has a more developed religious hierarchy possessing greater influence over society than does Sunni Islam. The *zakat* goes to the *ulama* (religious authorities) for redistribution. Furthermore, the Shi'is collect an additional 20 percent income tax, the *khums* that also goes to the *ulama*. In the *ulama* hierarchy under Imam or Vilayat e-faqih, the next rank is Grand Ayatollah and then Lesser Ayatollah. Below that is Hojjat-el-Islam, the rank held by current President Ali Akbar Hashemi Rafsanjani of Iran.

Another factor in the revolutionary attitude in Shi'ism is the history of oppression by the Sunnis. In Iraq, Bahrain, and Lebanon Shi'is outnumber Sunnis, but the latter are better off economically and are politically dominant. This situation dates from the defeat at Karbala, and the intense focus on martyrdom in memory of that defeat and the martyrdom of Husayn infuses Shi'ism. Thus on Ashura, the 10th of Muharram and the anniversary of Karbala, Shi'is publicly march, cursing the first three caliphs and sometimes flagellating themselves. On Ashura in December 1978, one-fourth of Iran's population was in the streets calling for the overthrow of the Shah and the return of Imam Khomeini, the final blow to the Shah's regime.

In Iran the official view on economic laws is Khomeini's in *A Clarification of Questions*. He agrees with the Sunnis on forbidding interest and supporting *zakat*, although the latter is to be voluntary and distributed by the *ulama*. He also supports the one-fifth income tax, or *khums*, for the *ulama*. He accepts land rent, sharecropping, and insurance, making him more moderate than some Sunni Islamic economists. In general he accepts private property.

Nevertheless, in 1979 he ordered the confiscation of properties owned by the former royal family and its associates. This signaled the ascension of "Islamic socialist" policies in line with those advocated by Ayatollah Taliqani.⁷

⁶Khomeini's sending cassette tapes from exile gave him an aura of the Hidden Imam. He exhorted the masses to martyrdom such as occurred at Karbala, and demonstrating crowds called for the return of "Imam Khomeini."

⁷See Ayatollah Mahmud Taliqani, *Ownership in Islam*, trans. from Persian by R. Campbell (Berkeley: Mizan Press, 1982).

This fit with Khomeini's call for redistributive justice and his denunciations of corruption in the Shah's regime. He opposed economic domination by foreigners or non-Muslims, especially Americans and Israelis, which he saw as happening under the Shah. Thus the confiscations justly aided the poor ostensibly, and they asserted Muslim Iranian independence from imperialistic domination by foreign non-Muslims. This policy conflicted with the more pro-market capitalist views in much of Khomeini's writings, a conflict played out ever since with a tilt away from the socialist approach emerging over time.

Historical Overview to the Revolution

Iran's territory largely coincides with that of the ancient seat of culture and civilization known as Persia.⁸ Just over 2,500 years ago Cyrus founded the Persian empire, core of Alexander the Great's realm later. After Alexander's death, successor states ruled from Persia until the Muslim conquest in 640, after which Persia was ruled from outside for centuries by multinational Muslim empires.

In 1501, Safavid leader Isma'il proclaimed himself Shah and established an empire with the modern borders of Iran. Isma'il was a Shi'i who claimed to be the Hidden Imam. He forcibly converted the previously Sunni Persians to Shi'ism and established the still existing Shi'i ulama hierarchy.

The Qajar dynasty came to power in 1785. Soon after, control of Persia was contested by Great Britain and Russia. The ulama opposed cooperation with these powers, provoking a war with Russia in 1828 that Persia lost. In 1872 the British gained the Reuter concession, which granted them control over mines, the national bank, and railroad construction in Persia. It was cancelled a year later after agitation by the ulama. But there was no opposition to the d'Arcy oil concession in 1901, the first in the Middle East, out of which came the Anglo-Persian Oil Company, now British Petroleum, after oil was discovered in 1908.

In 1906 some ulama combined with Western-oriented intellectuals to remove the Qajar Shah in the Constitutionalist Revolt, which resulted in a constitution modeled on Belgium's. Russian troops reimposed the Qajars in 1911. During World War I both Britain and Russia occupied portions of Persia. This humiliation led to removal of the Qajars in 1925 by the military commander, Reza Shah, who established the Pahlavi dynasty that lasted until 1979.

⁸*Persia* became *Iran* in 1935 to emphasize the Aryan, or Indo-European, origins of the Persians. Then leader, Reza Shah, was fascinated with Nazi ideologies of the "Aryan master race" and looked to Germany to offset British and Soviet domination. Shi'i Persians are about 60 percent of the population, and Shi'i Turkic Azeris are about 30 percent. Religious minorities include Sunnis, Baha'is, a group founded in Persia in the 1800s and much persecuted today, Christians, Jews, and Zoroastrians, the ancient Persian religion whose New Year is still celebrated in Iran.

Reza Shah followed a secularizing and nationalist course. He forbade women to wear traditional Islamic garb in 1928, stripped the ulama of control of the courts in 1932, and reduced their control over the wealthy religious endowments (*waqfs*) in 1934. He built up a strong military and a strong centralized state that suppressed ethnic minorities.

He also brought in German advisers to offset Britain and the Soviet Union. In 1941 the British and Soviets deposed him in favor of his son, Mohammed Reza Pahlavi, and respectively occupied Iran's south and north. In 1946 the United States pressured the Soviets to withdraw.

British control of the oil industry stimulated reemergence of a nationalist democratic coalition, led by Mohammed Mossadegh, a participant in the 1906 movement. He became prime minister in 1951, nationalized the oil industry, and deposed the Shah. Besides liberal nationalists his supporters included prominent ulama such as Ayatollah Taliqani, the later "Islamic socialist." In 1953 the CIA and British MI6 deposed Mossadegh, restored the Shah, and put the oil industry under the control of British Petroleum and some American companies.⁹

The Shah now followed U.S. foreign policy, joining the anti-Soviet Baghdad Pact of 1955 and maintaining friendly if covert relations with Israel. Internally he established tight dictatorial control enforced by his secret police, SAVAK. He opened the country to foreign investment and angered the ulama by elevating to wealth and power members of religious minorities.

In 1963 the Shah initiated the White Revolution to modernize and westernize Iranian economy and society. A crucial element included land reform involving distribution to peasants from major landowners, including the religious endowments (*waqfs*). This reform triggered protests led by Ayatollah Khomeini, who was exiled to Iraq and later to Paris from where he became the main opposition leader against the Shah.

In 1973 the Shah supported the OPEC oil price shock, which enormously increased revenues and income for Iran. Much of the money went to state-sponsored industrial development, but also much was siphoned to the Shah's cronies. Inflation soared, resulting in impoverishment of many Iranians while a few became very rich. As broad-based opposition to the regime spread, SAVAK's repression intensified, thus triggering more opposition.

The breadth of opposition to the Shah came to extend from landless peasants and the ulama through the bazaar merchants to government workers and the middle class. In January 1978, police fired on a pro-Khomeini demonstration by students in Qom, the religious center of Iran, and 70 died. This triggered a cycle of demonstrations and strikes every 40 days to memorialize those

⁹Known as "Project Ajax," this coup remains a source of controversy. The British government refuses to release documents relating to it. See Kermit Roosevelt, *Countercoup: The Bloody Struggle for Control of Iran* (New York: McGraw-Hill, 1979) and Daniel Yergin, *The Prize: The Epic Quest for Oil, Money and Power* (New York, Simon and Schuster, 1991) chap. 23, for further details.

martyred 40 days before. Civil unrest steadily escalated, even after martial law was declared in September. During Ashura demonstrations in December, millions were in the streets.

The Shah left the country on January 16, 1979, and on February 1 Khomeini returned to Tehran in triumph, welcomed by a crowd estimated at 2 million. The Islamic Revolution had achieved victory over the secularizing monarchy.

Iran's Economy before and after the Revolution

The Revolution after the Revolution

The victory of the Islamic Revolution initiated a period of two and a half years of intense power struggles with serious violence erupting on all sides. Many of those arrested for opposing the regime then were charged with being "Corrupters of the Earth" and were executed. Justification for such extreme measures heightened after Iraq invaded Iran in September 1980, beginning a war that lasted until 1988, the bloodiest in the world since World War II.

During 1979 the Revolutionary Council issued many radical economic proposals. Its members included the Islamic socialist, Ayatollah Talaqani, and his ally, Abolhassan Bani-Sadr, who became prime minister two days after Revolutionary Guards seized the U.S. embassy and took those inside hostage in early November 1979.

A month later the Islamic constitution was adopted that mandates the Vilayat-al-faqih concept. A legislative assembly (*Majlis*) was established, which was dominated by Islamic fundamentalists. The constitution also called for a prime minister and a president, and Bani-Sadr was elected to the presidency in January 1980. After more violence he was replaced in 1981 by Ayatollah Ali Khamene'i who was president until Khomeini's death in June 1989, when Khamene'i succeeded Khomeini as Vilayat-al-faqih. Hojjat-el-Islam Ali Akbar Hashemi Rafsanjani was elected president and the position of prime minister was eliminated.

The Islamic constitution also mandates a body of 12 ulama, the Council of Guardians, who pass on the "Islamicness" of any legislation. In the struggle over economic policy this body became the bastion of pro-market capitalist forces, blocking a bill to nationalize foreign trade in 1982 and a land reform bill in 1983. It represented the interests of the urban bazaar merchants and also large landlords, including some ulama.¹⁰ As of

¹⁰See Mansoor Moaddel, "Class Struggle in Post-Revolutionary Iran," *International Journal of Middle East Studies* 23 (1991), pp. 317-43. American commentators have been confused by the most anti-American groups in Iran being the most pro-market. Thus the American terminology of "radicals" and "moderates" has been meaningless.

Khomeini's death, the Council of Guardians had vetoed approximately 48 percent of the bills passed by the assembly.¹¹

We can identify four periods in economic policy since the revolution. First is the First Radical Phase, which lasted from 1979 to 1981, or through the main postrevolutionary power struggle. This period saw a wave of nationalizations and confiscations as well as proposals for foreign trade nationalization and land reform, later blocked by the Council of Guardians.

The Second Radical Phase lasted from 1982 to 1984 and was marked by more emphasis on strictly Islamic policies such as implementing interest-free banking rather than the more socialist-oriented policies of the previous phase. The role of the Council of Guardians, supported by Khomeini, was crucial.

From 1985 to 1989 was the First Pragmatic Phase. No major innovations in economic policy came during this period, but Iran opened to the outside world and softened its attitude towards the United States under pressure of the Iran-Iraq war. Real incomes declined and economic crisis set in. Secret arms purchases from the United States culminated in the Iran-contra scandal there.

The Second Pragmatic Phase, from 1989 to the present, coincides with the presidency of Rafsanjani and has been marked by some privatizations of state enterprises and moves towards integrating into the world economy, including obtaining a loan from the World Bank in 1993, while maintaining Islamic economics internally and active support for fundamentalist Islamic movements abroad.

The Economy of Iran under the Pahlavis

In a sense, the Islamic Revolution did not fundamentally alter Iran's economy, which was dominated by the state sector, especially after the oil nationalization in the early 1970s. Iran's economy ran on oil and runs on oil. The "revolution" was that a different group came to control this state-run oil machine.

State-led development dated from the 1920s in Reza Shah's nationalist drive for autonomous development. Using modest oil revenues public enterprises were established in textiles, sugar, cement, iron, and steel; infrastructure was built up; and the state loaned money to tariff-protected private sector development in an import substitution industrialization strategy. In 1944 Mohammed Reza Pahlavi established comprehensive indicative central planning. From the late 1950s through the early 1970s capital investment was nearly evenly split between the public and private sectors with the former concentrating on iron, steel, copper, machine tools, aluminum, and petrochemicals, and the latter concentrating on finished metals and specialty steels, synthetic fibers, paper, automobile assembly, and sugar, some of these in joint ventures with foreign capital.

¹¹Nader Entessar, "The Challenge of Political Reconstruction in Iran," in *Modern Capitalism and Islamic Ideology in Iran*, eds. C. Bina and H. Zangeneh (New York: St. Martin's Press, 1992), p. 229.

The 1973 oil price shock generated a surge of revenues into state coffers and investment shifted towards the state sector. Whereas in the Fourth Development Plan (1968–1972) there were 141 billion rials of private investment and 146 billion rials of public investment, during the Fifth Development Plan (1973–1977) the respective figures were 319 billion rials and 734 billion rials.¹² By 1978 government spending was 43 percent of GNP and military spending was 10 percent of GNP. Of the nonagricultural labor force, 25 percent was on the government payroll.¹³

Despite this industrialization much of the labor force remained in agriculture, which was dominated by sharecropping relationships between landless workers and absentee landlords, often ulama or religious organizations (waqfs).¹⁴ After the Shah's 1963 land reform a major rural-urban migration occurred and a majority of the population was urban by the 1980s.

The dominant feature of Iran's foreign trade was overwhelming dependence on oil exports. Even in the 1960s the percentage of export earnings due to oil exports never fell below 85 percent. After the oil price increase of 1973 this percentage soared to 97 percent and stayed above 94 percent until oil prices dropped in 1986 (see Table 16–2). That the percentage remains high after 1979 contradicts one of the goals of the revolution, which was to reduce the dependence on oil exports. But war with Iraq forced continuing reliance on this source of hard currency. Table 16–1 shows Iranian oil production in relation to OPEC and world production over time, whereas Table 16–2 shows oil exports, their percentage of total exports over time, and the average price of Iranian light crude oil.

The surge in oil revenues after 1973 triggered double-digit real growth rates of GDP but also double-digit inflation rates. Inflation combined with an increasing inequality of income to fuel the fires of revolutionary fervor that exploded in 1978. With strikes, the exodus of foreign technicians, and general upheaval, both oil production and GDP fell in the immediate aftermath of the revolution. Both grew again after 1981, only to decline in 1986. GDP declined again in 1987 under the pressure of the war, but its end saw a return to growth for both oil production and GDP. Inflation has remained at double-digit levels except in 1985. The Gulf War period saw a surge of oil exports and economic growth, which has slowed down since then. Statistics on real GDP growth rates and CPI inflation rates are shown in Table 16–3.

¹²H. Razavi and F. Vakil, *The Political Environment of Economic Planning in Iran, 1971–1983* (Boulder: Westview, 1984), p. 66.

¹³Alan Richards and John Waterbury, *A Political Economy of the Middle East: State, Class, and Development* (Boulder: Westview, 1990), p. 207.

¹⁴There was a tradition dating from the Mongol invasions of insecure land tenure in Iran even among the wealthiest families. This led many to donate land to the waqfs, the charitable organizations controlled by the ulama, so as to avoid seizures by governments.

TABLE 16-1 Iran and OPEC, Shares of World Production

Year	World Total	OPEC	Iran	OPEC Share %	Iran's Share %	
					World	OPEC
1973	55.7	31.0	5.9	55.6	10.6	19.0
1975	52.8	27.2	5.3	51.5	10.0	19.5
1979	62.5	31.0	3.2	49.6	5.1	10.3
1980	59.4	27.0	1.7	45.4	2.9	6.3
1981	56.0	22.8	1.4	40.7	2.5	6.1
1982	53.2	19.0	2.2	35.7	4.1	11.6
1983	53.0	17.9	2.4	33.8	4.5	13.4
1984	54.2	17.9	2.2	33.0	4.0	12.3
1985	53.6	16.6	2.2	31.0	4.1	13.2
1986	55.9	18.7	2.0	33.4	3.6	10.7
1987	56.3	18.8	2.3	33.4	4.1	12.2
1988	58.5	21.0	2.2	35.9	3.8	10.5
1989	59.5	22.6	2.8	38.0	4.7	12.4
1990	61.2	24.3	3.1	39.7	5.1	12.8
1991	60.1	23.6	3.3	39.3	5.5	14.0
1992	60.2	24.9	3.4	41.4	5.6	13.6
1993	60.1	25.7	3.6	42.8	6.0	14.0
1994	60.4	25.8	3.6	42.7	6.0	14.0

Source: U.S. Department of Energy, *Monthly Energy Review*, November 1994, Tables 10.1a,b, pp. 130-31. 1994 figures are extrapolated from the first eight months. Volume figures are in millions of barrels per day.

Policy and Performance after the Revolution

The Nationalization Question. The state sector gained in the immediate aftermath of the revolution as the nationalizations and confiscations ordered by Khomeini took place. This ended with the removal of Bani-Sadr from office at the end of the First Radical Phase, when the Council of Guardians asserted the right to private property. The current policy trend in the Second Pragmatic Phase under Rafsanjani sees some privatizing of the state sector and even the opening of a stock exchange in 1990.

Confiscations from the Pahlavi family and their retainers began in March 1979. These confiscations went to a body controlled by the ulama and some bazaar merchants known as the Mustaz'afan Foundation, or "Foundation of the Oppressed."¹⁵ The proceeds were to aid the poor, especially in developing low-income housing projects. By 1981 the Mustaz'afan was managing

¹⁵Scandals involving management of this foundation's funds led Khomeini to wisecrack that "the foundation for the needy has turned into the foundation for the greedy."

TABLE 16-2 Iranian Petroleum Exports

Year	Value of Petroleum Exports	Oil as Percent of Total Exports	Price in Dollars per Barrel Iranian Light-34 API
1967	1.75	90.6	n.a.
1970	2.36	98.1	1.36
1973	5.62	90.5	2.11
1974	20.90	97.0	10.63
1975	19.63	97.3	10.67
1976	22.92	97.4	n.a.
1977	23.60	97.3	n.a.
1978	21.68	96.5	n.a.
1979	19.19	96.9	13.45
1980	13.29	94.2	30.00
1981	12.05	95.7	37.00
1982	19.23	99.0	34.20
1983	19.22	99.2	31.20
1984	12.26	98.7	28.00
1985	13.11	98.4	28.00
1986	7.20	88.9	28.05
1987	10.00	90.2	16.15
1988	6.04	n.a.	13.26
1989	9.02	n.a.	16.04
1990	13.42	n.a.	20.64
1991	13.64	n.a.	17.37
1992	13.26	n.a.	17.73
1993	11.98	n.a.	14.34

Source: Exports and percentage of exports through 1987 are from Cyrus Bina, "Global Oil and the Oil Policies of the Islamic Republic," in *Modern Capitalism and Islamic Ideology in Iran*, eds. C. Bina and H. Zangeneh, (New York: St. Martin's Press, 1992), p. 129, constructed from *OPEC Annual Statistical Bulletins*. The price of oil though is from Bina, "Global Oil," p. 144, constructed from U.S. Department of Energy reports. The price of oil 1988-93 is from Cyrus Bina, "Oil, Japan, and Globalization," *Challenge* 37, no. 3 (1994), p. 47. Value of petroleum exports for 1988-93 is estimated by multiplying the price by a volume figure from *International Financial Statistics*, International Monetary Fund, December 1994. Exports are in billions of U.S. dollars.

149 industrial units, 64 mining units, 472 agricultural units, 101 construction units, 25 cultural units, 238 commercial units, and 2,786 real estate units.¹⁶ In 1985 the Council of Guardians ordered the return of 180 of these to their original owners.

¹⁶Mehrdad Valibeigi, "Islamization of the Economy: The Post Revolutionary Iranian Experience," Ph.D. thesis, Department of Economics, American University, 1991. Although Mustaz'afan is the largest and wealthiest, there are other such foundations. Some aid the international Islamic revolutionary movement by acts such as offering a bounty of several million dollars for the assassination of novelist Salman Rushdie or by funneling millions of dollars to Muslim opposition groups in Algeria and other countries (Gary Sick, "The Two Faces of Iran: Rafsanjani's Moderation, the Mullahs' Holy Terror," *Washington Post*, April 4, 1993, pp. C1-C2).

TABLE 16-3 Iranian Real GDP Growth and Inflation Rates

<i>Year</i>	<i>Real GDP Growth Rate</i>	<i>CPI Inflation Rate</i>
1974-75	6.9	14.7
1975-76	2.6	12.8
1976-77	12.1	10.9
1977-78	11.1	27.6
1978-79	-16.7	11.7
1979-80	-6.0	10.5
1980-81	-20.8	26.0
1981-82	8.9	22.4
1982-83	14.0	19.2
1983-84	8.8	17.7
1984-85	2.8	10.5
1985-86	4.2	4.1
1986-87	-8.1	20.8
1987-88	-0.1	27.8
1988-89	2.2	28.9
1989	3.3	22.4
1990	11.7	7.6
1991	11.4	28.2
1992	5.7	31.0
1993	0.2	35.8

Source: Data through 1988-89 are from Adnan Mazarei, Jr., "The Iranian Economy Under the Islamic Republic: Institutional Change and Macroeconomic Performance (1979-90)," Working Paper 616s, Department of Economics, UCLA, 1991, Table 4, constructed from data from the Central Bank of the Islamic Republic of Iran. The years are according to the Iranian calendar and begin when astrological ones do, that is on the vernal equinox, March 21. For 1989-93, data are constructed from *International Financial Statistics*, International Monetary Fund, December 1994.

In June 1979 all banks and insurance companies were nationalized. In July a comprehensive nationalization law was passed that established the Organization of Nationalized Industries (ONI), which was to run the nationalized firms. 580 firms were affected in nine categories: food, electricity and appliances, construction equipment, textiles, pharmaceuticals, shoes and leather, paper and wood, chemicals, and cement. Besides firms viewed as crucial to the economy, those nationalized were either set up by families connected to the Shah or had liabilities to the banking system exceeding their assets. In 1990 the government offered minority shares for sale in 400 state-owned firms.¹⁷

The Islamic constitution, passed in December 1979, mandated public control of all major industries, foreign trade, major mines, banking, insurance, power, dams, major irrigation systems, air, sea, land, and railroad transport. In 1980 the government attempted to nationalize control of foreign trade, of

¹⁷Valibeigi, "Islamization of the Economy," pp. 76-79.

which it already controlled about 40 percent. Legislation mandating such control was passed, but the Council of Guardians declared it to be in nonconformity with Islam because it would take away the rights of merchants and establish a state monopoly. Eventually in 1984 compromise legislation was passed under which the state would import necessary goods and the remaining foreign trade would be privately controlled.

The Land Question. In late 1979 the Revolutionary Council decreed that confiscated, unclaimed, uncultivated public lands possessed by private agencies and certain scattered woodlands and pastures would be available for redistribution. In 1980 a bill to eliminate leasing and sharecropping passed that limited private farm sizes to three times what was necessary to support a family and that turned large-scale mechanized farms into cooperatives. A committee of seven members was to redistribute land. Between April and November 1980, they redistributed slightly over 1 million hectares of land out of 14 million arable hectares in Iran. Then Khomeini suspended the law and the committee under pressure from the grand ayatollahs and large landlords. A more moderate bill was passed in December 1982, but it was rejected by the Council of Guardians in January 1983.

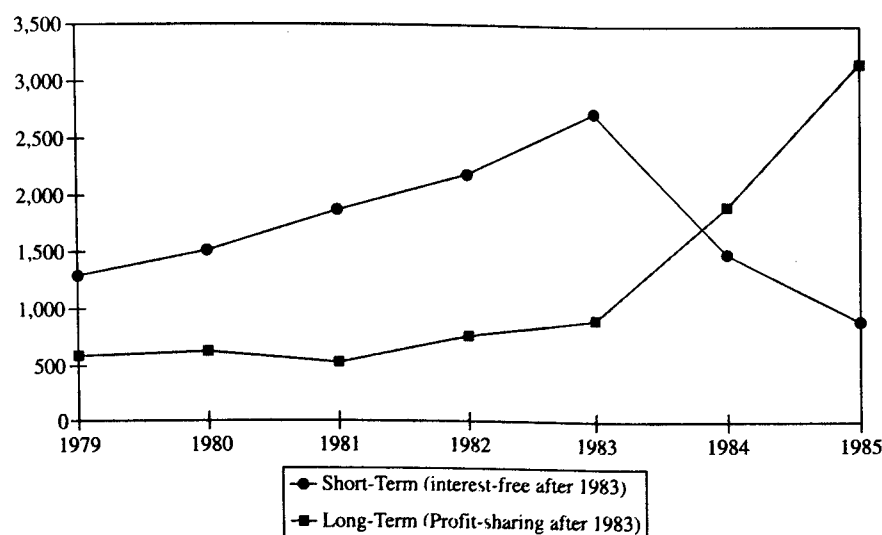
An urban land law was passed in 1982 that was upheld by the Council of Guardians. It nationalized uncultivated land, land with unknown ownership, and portions of parcels in excess of 3,000 square meters in size. The goal was to develop housing for the poor, and the amount of investment in construction doubled between 1978 and 1983 whereas investment in mining and industry fell sharply during the same period.¹⁸ But this program has not led to expanded housing and has become bogged down in bureaucracy and corruption.¹⁹

Labor-Management Relations. Many Islamic economists argue (see Chapter 5) that cooperative workplace relationships are preferable to the standard hierarchical, boss-worker pattern. During the revolution workers' councils spontaneously appeared in some industries. Many called for nationalizing their particular industry, and when nationalization occurred the councils were often disbanded. In some cases, notably oil, the councils supported Marxist opponents of the government and were violently suppressed.

Provisions for Islamic Workers' Councils (*Shourahs*) were promulgated in 1980. But when more restricted legislation was passed in December 1982, it was rejected by the Council of Guardians. A temporary labor law was passed in 1991, but it leaves even less scope for workers' councils. Thus this aspect of Islamic economics has been frustrated in favor of a more standard approach after an attempted beginning.

¹⁸Valibeigi, "Islamization of the Economy," p. 157.

¹⁹Ali A. Kiafar, "Urban Land Policies in Post-Revolutionary Iran," in Bina and Zangeneh, *Modern Capitalism*, pp. 235-56.

FIGURE 16-1 Short-Term and Long-Term Bank Accounts in Iran
(Billions of Rials)

Source: From Mehrdad Valibeigi, "Islamization of the Economy," Ph.D. thesis, Department of Economics, American University, 1991, Table 28, p. 145. The figures are compiled from the Statistical Year Book of Iran for 1985 and 1987. They are in billions of rials.

Interest-Free Banking in Iran. As noted in Chapter 5, eliminating interest (*riba*) is probably the most distinctive feature of Islamic economics. Iran became the first modern Islamic state to implement nationwide interest-free banking, since followed by Pakistan and Sudan. The elimination of interest was carried out in two stages.

First, in February 1980 the Supreme Council of Money and Credit was formed, and it passed a resolution calling for eventual abolition of all interest. As a preliminary step it replaced interest in banking transactions with "service charges" and set service charge rates for particular kinds of loans and accounts. This was criticized by radical Islamic elements as superficial.

But fears of complete Islamization led to a panic among depositors in late 1980 when Iraq invaded Iran, and long-term savings accounts dropped by about 15 percent from 1980 to 1981.²⁰ This forced Khomeini to declare that banks' giving prizes to depositors was Islamically legitimate. The policy of prizes implies a varying return because the prizes contain an element of randomness, not unlike many Western bond funds.

The second stage was implemented in 1983 with a comprehensive Law of Interest-Free Banking. Interest on short-term deposits was eliminated. Long-term accounts could share in profits from loans. This policy led to a dramatic shift from short-term to long-term accounts after 1983 as shown in Figure 16-1 above.

²⁰Valibeigi, "Islamization of the Economy," p. 143.

The 1983 law also granted the Central Bank of Iran the right to determine the overall volume of credit expansion, possible rates of returns for certain kinds of partnerships and lease arrangements, service charge levels, and ranges for credit in the various allowed forms of profit-sharing arrangements. In July 1990 the Central Bank used an increase in the allowed rates of return as a contractionary monetary policy to sop up excess liquidity and combat accelerating inflation.

As noted in Chapter 5, the majority of loans by Iranian banks are of the sort that look more like interest arrangements than of the sort that are clearly profit-sharing arrangements. Many argue this is essentially a semantic issue and that the term *interest* is replaced by the term *profit*. However, the banks are partners rather than lenders under this system, especially given the lack of deposit insurance.

It can be argued that the more important change in Iranian banking was the nationalization of the banks in 1979 and the state direction of investment that resulted. This state direction cut investment in industry and mining and increased it in construction. This shift might have occurred anyway, but it reflects the social emphasis on housing construction and reconstruction as war damage by Iraq escalated. This shift of investment may mean that not only the issue of Islamic banking but more broadly that of Islamic economics is secondary to the conflict between capitalism and socialism (private versus nationalized banking). This continuing conflict is just what some Islamic economists point to in disputing that Islamic economics represents a superior Third Way between capitalism and socialism.

The Distribution of Income. A driving force of the revolution was resentment of the increasing income and wealth inequalities in the 1970s. This resentment fed the Islamic demand for social justice and supported the “Islamic socialist” trend in power in the immediate aftermath of the revolution. Despite the disruptions and economic decline that came out of the revolution, increased equality of income was one initial success. But inequalities have since re-emerged, possibly to a greater level than before the revolution.

Table 16–4 presents measures of inequality of household expenditures, accurate data on incomes being unavailable.²¹ For both urban and rural households quintile ratios and Gini indexes are presented for selected years. These quintile ratios are the ratio of household expenditures by the richest 20 percent of the population to that by the poorest 20 percent. For the Gini index a higher value indicates greater inequality.

Most reductions in inequality occurred early after the revolution, although in rural areas an initial increase in inequality occurred before a reduction. In urban areas the main factors were sharp reductions in incomes of wealthy individuals because of the confiscations and nationalizations during 1979 to 1981

²¹Because such data do not account for savings, they tend to overstate any degree of equality.

Box 16-1

Policies towards Women and Family Planning

The Shah's 1963 White Revolution granted women the right to vote, and their family law rights were strengthened in 1967. Women had not been subject to Islamic dress codes from the 1920s. Women were allowed to enter a variety of professions and many did so. Educational opportunities expanded as female adult literacy rose from 17 percent in 1970 to 30 percent in 1980, compared to 55 percent male adult literacy in 1980.*

With the Islamic Revolution, sexual segregation in education, employment, and public activity was decreed. Birth control and abortion were forbidden. A strict dress code was imposed, violation of which was punishable by up to 74 lashes of a whip.[†] These restrictions continue with slight relaxations since 1990 in employment, where women may now work in several previously forbidden areas, and in family planning and birth control.

Between 1965 and 1980 the population growth rate of Iran was 3.1 percent per year, a high rate implying that the population doubled every 23 years. Between 1980 and 1990 this rate accelerated to 3.6 percent per year, one of the highest in the world, implying a doubling time of less than 20 years.[‡] The increased population growth rate reflects the impact of Islamization on women and the pressure on them to stay home and have children.

It became harder to raise real per capita incomes as the dependency ratio increased. Although real GDP rose in most years since the revolution, real *per capita* income steadily fell. Iran's real per capita income in U.S. 1988 dollars went from 7,988 in 1980 to 7,252 in 1985 to 6,132 in 1988.[§] By 1992 its estimated purchasing power parity (PPP) per capita income in 1992 U.S. dollars was 5,280.[¶]

Policy makers in Iran have decided that rapid population growth contributes to the problem of falling per capita income and have moved towards relaxing family planning policies. However this move is opposed by the stricter ulama and is very controversial. Thus the government hesitates to fully implement family planning and emphasizes study of the issue.[‡]

*Alan Richards and John Waterbury, *A Political Economy of the Middle East: State, Class, and Development* (Boulder: Westview, 1990), pp. 88, 113.

†Ann Elizabeth Mayer, "The Fundamentalist Impact on Law, Politics, and Constitutions in Iran, Pakistan, and the Sudan," in *Fundamentalisms and the State: Remaking Politics, Economies, and Militance*, eds. M. E. Marty and R. S. Appleby (Chicago: University of Chicago Press, 1993), pp. 115–16. Traditional Iranian Shi'i clothing for women is the chador, a black garment that completely covers the entire body except for the eyes.

‡World Bank, *World Development Report 1992* (New York: Oxford University Press, 1992), Table 26, p. 269. This rate has declined somewhat since 1990.

§*Statistical Abstract of the United States* (Washington: USGPO, 1991), Table 1446, p. 841.

¶World Bank, *World Development Report 1994* (New York: Oxford University Press, 1994), Table 30, p. 221. This figure may not be comparable with the others.

‡1992 personal communication from Ralph Andreano who represented the World Health Organization on a mission to Iran.

TABLE 16-4 Measures of Household Expenditure Inequalities

<i>Year</i>	<i>Quintile Ratio— Urban</i>	<i>Gini Index— Urban</i>	<i>Quintile Ratio— Rural</i>	<i>Gini Index— Rural</i>
1977	14.7	0.4998	9.4	0.4375
1979	12.9	0.4702	11.7	0.4789
1980	9.1	0.4040		
1982	10.6	0.4168	8.5	0.4051
1983	12.2	0.4282	10.7	0.4161
1984	11.4	0.4205	11.3	0.4293

Source: Constructed from Sohrab Behdad, "Winners and Losers of the Iranian Revolution: A Study in Income Distribution," *International Journal of Middle East Studies* 21 (1989), pp. 327-58, Tables 5 and 8.

and an increase in income for the working class from an increased minimum wage. Also the income tax code became more progressive. Since the end of the First Radical Phase a trend back towards greater inequality has emerged.

The initial increase in inequality in rural areas coincided with agricultural price hikes in 1978 and 1979, which large-scale farmers took advantage of. These higher relative prices persist, causing a relative improvement of rural incomes relative to urban incomes, although the latter are still about twice the former in per household terms. Less dramatic than in urban areas, the movement towards equality was probably due to the 1980 land reform redistributions before Khomeini and the Council of Guardians halted them. There has been a drift back towards greater inequality in rural areas, as in the urban areas.²²

The college educated have been noticeable as relative losers whereas the illiterate have been noticeable as relative gainers in the income distribution. An obvious, if unprovable hypothesis is that the highly educated are less devout compared to the illiterate. However, there remains a positive correlation between educational level and income in Iran.²³

Macroeconomic Imbalance and Rent-Seeking. Given the fall in oil prices in 1986, pressures of the war with Iraq, trade sanctions by the United States, and general revolutionary upheaval, serious macroeconomic imbalances emerged in Iran. In the late 1980s inflation accelerated (see Table 16-3), the current account balance went into deficit, and the budget deficit sharply increased. Nevertheless, until April 1993, the government refused to devalue the rial against foreign currencies (it was pegged to the IMF's Special Drawing

²²This trend has continued in both areas at least to 1989. Mehrdad Valibeigi ("Distributive Justice Under the Islamic Republic of Iran," paper presented at Eastern Economic Association meetings, [Boston, 1994], Tables 1 and 2) finds the percentage share of household expenditures in the richest fifth to have been 69.74 in 1977, 54.43 in 1984, and 60.43 in 1989 in urban areas and 49.83 in 1977, 47.96 in 1984, and 55.17 in rural areas.

²³Sohrab Behdad, "Winners and Losers of the Iranian Revolution."

Right [SDR]) and tried to deal with the external imbalance by “import compression” and very strict tariffs and quotas. The outcome of this policy was summarized by Pesaran:

The result has been rising domestic inflation, a surge in rent-seeking activities at the expense of production, promotion of corruption, misallocation of resources from manufacturing to trade and distribution, and a significant policy bias against investment.²⁴

It is inaccurate to blame these disorders upon Islamization of the economy. Rather they arose from pride regarding the value of the rial in the face of shocks and disruptions and hostility of much of the outside world, which beyond a certain point introduced distortions that became self-feeding. Ultimately the problem originates with Iran’s history as a major oil exporter and its inability to adjust to lower oil prices and reduced oil markets. Nevertheless, there has been a substantial sectoral reallocation of resources towards trade and away from industry.²⁵

A measure of the overvaluation of the rial is the ratio of black market price for U.S. dollars compared to the official price. The gap steadily increased to about 5 to 1 around 1982 and then fell back a bit, but took off again in 1984. In November 1989 it reached a level of almost 20 to 1.²⁶

Overvaluation made it difficult for any industry to compete with foreign producers, despite extensive protectionism. This reinforced the dependence of the economy on oil exports for hard currency earnings, even as the market for oil continued to lack strength. Access to imports depended on obtaining appropriate licenses from government officials, allowing a classic setup for corruption and rent-seeking.

The extreme difficulties of 1989 led the Rafsanjani government to introduce multiple exchange rates as the Second Pragmatic Phase began. Combined with the world embargo against Iraq after the 1990–91 Gulf War, which increased Iran’s oil export market, economic conditions improved for a while in Iran and inflation fell, per capita income rose, and capital investment rose. This improvement ended by 1993 with a renewed outburst of inflation and continuing weakness in oil prices. The government loosened import restrictions and let the rial float, which led to a loss of more than half its value against the U.S. dollar. But conditions simply worsened and in 1994, restrictions were reimposed on imports, multiple exchange rates were reintroduced, and plans to remove subsidies to various groups and to sell off assets owned by religious foundations were shelved.

²⁴M. Hashem Pesaran, “The Iranian Foreign Exchange Policy and the Black Market for Dollars,” *International Journal of Middle East Studies* 24 (1992), p. 119.

²⁵Nations that export large quantities of a primary resource find it difficult to develop or maintain industry because their export earnings drive up the value of their currency, making it difficult for industry to compete and survive. This phenomenon is called the “Dutch disease” following events in the Netherlands when major natural gas reserves were discovered there.

²⁶M. Hashem Pesaran, “The Iranian Foreign Exchange Policy,” p. 116.

Ultimately the policy flip-flops of the Rafsanjani regime reflect an ongoing conflict between radical fundamentalist ulama who seek world revolution and isolation from the world economy and a more pragmatic group seeking renewed economic growth through market-oriented reintegration into the world economy.

Is Iran the Model for the New Traditional Islamic Economy?

Is a new traditional economy really possible and is Iran the model for it? There is no simple answer to this question, as the discussion above should indicate.

For better or for worse, Iran *is* the fountainhead of the international movement for Islamic society and economy, a significant material and spiritual supporter of the most radical factions of this movement. But in the longer run it may not be the role model it is now for those societies that attempt this particular experiment in the future.

A major reason is the Shi'i character of Iran's revolution, which results in at least two peculiar aspects. One is that Iran is ulama dominated—Iran is a theocratic state ruled by the Vilayat-al-faqih, supported by ulama control of the zakat. The Sunni tradition emphasizes more "separation of church and state." Rather than arbitrary promulgations of law codes by Supreme Jurists, the Sunnis accept existing law codes and demand that nonclerical Heads of State, whether hereditary monarchs, usurping military dictators, or democratically elected presidents, adhere to and enforce those codes. If they do not, then they can be overthrown by the Islamic movement. But the Sunni hierarchies, less wealthy and powerful than the Iranian Shi'i one, do not generally demand direct power *for themselves*.

Furthermore the history of oppression and grievance within Islam of the Shi'is has led them to a redistributionist radicalism expressed in the Islamic socialism of the First Radical Phase immediately after Iran's revolution. Given the general discrediting of world socialism and the not-so-aggrieved position of the traditionally dominant Sunnis, Sunnis are less inclined to Iranian-style radicalism.

However, the anti-Western and anti-neocolonialist sentiments felt throughout much of the Islamic world give credence to the strong position taken by Iran and account for the increasing influence of Iran among many Sunni fundamentalist movements. The sense of oppression of the Shi'is allows them to articulate more clearly the frustrations and anger of many throughout the Islamic umma.

But more moderate role models exist, some arguably more Islamic, that may eventually be more influential on Islamic economic experiments in the future. Among these are the predominantly Sunni nations of Saudi Arabia and Pakistan (see Box 16-2). Saudi Arabia is highly influential because of its vast oil wealth, its position as site of the Muslim holy cities of Mecca and Medina, and its long adherence to the strict Hanbali law code. It practices state-gathered zakat but does not enforce interest-free banking.

Box 16-2

Pakistan: The Most Authentic Islamic Economy?

A serious, if less dramatic model, is Pakistan. As noted in Chapter 5, many Islamic economists have been of Pakistani origin. In the modern world Pakistan was the first state specifically established as an Islamic state, although its founders sought a secular system of governance. Its approach to Islamization has been quieter and more gradual than Iran's. But it may have a more truly Islamic economy than Iran. Given its Sunni orientation, these achievements may make it more influential in the long run with the majority of Islamic nations.

Since independence in 1947, Pakistan has alternated between democratically elected governments and military dictatorships. It has experienced wars with neighboring India, the loss of its former province of East Pakistan, now Bangladesh, in 1971, and considerable internal ethnic and religious strife, much of the latter between majority Sunnis and minority Shi'is. Not being an oil producer, Pakistan has remained at a lower level of per capita income and economic development than have either Iran or Saudi Arabia, but it has avoided the wide fluctuations in growth rates those countries have experienced. Its record has been one of real, but slow and steady economic growth.

In 1980, influenced by Iran's revolution, the military dictator, Zia al-Huq, declared Islamization the official policy of the country. Despite backsliding under the rule of Benazir Bhutto, Islamization remains official policy. Its implementation has been more gradual than in Iran, not socialist, but arguably more complete.

In contrast to Iran, Pakistan has a state-managed zakat system. In contrast to Saudi Arabia it has a full-blown Islamic banking system, although subject to the same kinds of subterfuges and superficialities as in Iran. It has not engaged in widespread nationalizations or confiscations. Aside from supporting Islamic fundamentalists in neighboring Afghanistan and Muslim separatists in neighboring Kashmir, Pakistan has largely avoided proselytizing its system abroad.

But Saudi Arabia's wealth and its dependence upon the United States for protection against Iraq make it suspect among Islamic radicals. The Saudi monarchy is antirevolutionary and among the most reactionary regimes in the world. Thus, while it inspires respect among many Muslims, it also inspires contempt in the eyes of global Islamic revolutionaries, and Saudi Arabia faces an internal ultrafundamentalist opposition movement.

Thus Iran is the most prominent global role model for would-be Islamic economics, despite its peculiarities and idiosyncracies. Ultimately the current regime must deal with its own contradictions. It is pulled in the direction of pragmatism, partially released from international ignominy by the shenanigans

of Saddam Hussein in Iraq. Its vast oil resources, its base of industry, and its educated entrepreneurs offer great potential for economic growth.

But the pragmatists come into conflict with the now firmly entrenched ulama who adhere to the vision of Khomeini of Iran as the fountainhead of the general Islamic revolution. Any move to seriously reintegrate with the world economy will draw forth opposition from these figures, just as the ulama opposed such policies when they were attempted by the Qajars and the Pahlavis. Furthermore the ongoing effort to support radical and even terrorist Islamic movements around the world keeps Iran in a pariah position with much of the world, including even many Islamic regimes. Its current military buildup and apparent drive for nuclear weapons terrifies its Arab neighbors in the Persian Gulf, including Saudi Arabia whose opposition to the ultimate overthrow of Saddam Hussein at the end of the Gulf War was precisely predicated on the fear that he is all that stands between them and an aggressive and expansionistic Iran, driven by its imperial dreams of glory, made all the more excessive by its aggrieved and impassioned sense of Shi'i martyrdom.

In the end, the more Iran stands out as the antiimperialist, anti-Western, antihegemonist voice of the Islamic Third World, an economic Third Way, and the dispossessed of the world, the more it will thrust itself forward as the definitive role model that all Islamic revolutions must emulate or be overthrown by their discontented radical fringes. At the same time such a stance will undermine its appeal as a model because it will undermine its ability to grow economically. Thus in the competition for influence in newly independent Central Asia it may well ultimately falter and fail as the great alternative to capitalism and socialism.²⁷

Summary and Conclusions

Iran is not a typical Muslim state because it is dominated by Shi'ism, the minority branch of Islam, and because it is a major oil producer and exporter. However its Shi'i traditions significantly contributed to the emergence of the Islamic revolution in Iran and as the leading role model of that revolution even among predominantly Sunni nations. These traditions include a sense of aggrieved martyrdom because of long domination by the Sunni majority, the particular strength of the Shi'i ulama based on their independent sources of funding and their ability to order the behavior of followers, and the messianic thrust associated with the idea of the mystical 12th and Hidden Imam who is

²⁷The Iranian revolution's self-image as the Third Way between the two "Great Satans" of the United States and the then-USSR is symbolized by a chant heard on the streets during the revolution. "Cheerleader: Who took our oil? Crowd: America. Cheerleader: Who took our gas? Crowd: Russia [The Shah sold natural gas to the USSR]. Cheerleader: Who took our money? Crowd: Pahlavi" (Michael M. J. Fischer, *Iran: From Religious Dispute to Revolution* [Cambridge: Harvard University Press, 1980], p. 190).

to return to save the world. Ayatollah Ruhollah Khomeini's claim to being the special messenger of this Hidden Imam allowed him to become supreme leader and jurist, the *Vilayat-al-faqih*, of the theocratic revolutionary state in Iran.

After a glorious past as center of ancient empires, the nation was conquered by Islam and ruled by outsiders for centuries. It converted to Shi'ism under the reign of Shah Isma'il after 1501. During the 19th century, Russia and Great Britain contested for Iran with the Shi'i ulama opposing accommodation with either of them diplomatically or economically. In the 20th century, secular nationalist movements arose in the form of the Pahlavi dynasty and in democratic movements such as the Constitutionalist revolt of 1906 and the regime of Mohammed Mossadeq in the early 1950s. After the 1973 oil price shock, inflation, corruption, and increasing inequalities of income and wealth fed discontent and support for Islamic revolution. In 1979 the Shah's regime was replaced by the Islamic regime of Khomeini.

The postrevolutionary period has gone through four phases. The First Radical Phase, 1979–1981, saw an Islamic socialist approach with widespread confiscations and nationalizations. In the Second Radical Phase, 1982–1984, further moves in that direction such as a rural land reform bill and a proposal to nationalize all foreign trade were blocked by the pro-market capitalist Council of Guardians who can declare legislation to be in nonconformity with Islam and therefore invalid. This phase was marked by more traditional Islamic innovations such as the adoption of interest-free banking. This period and the First Pragmatic Phase, 1985–1988, were dominated by the war with neighboring Iraq. The Second Pragmatic Phase emerged after the end of the war and the death of Khomeini. President Rafsanjani has moved towards marketization, privatization, and increased involvement in the world economy while trying to maintain Islamic practices and structures at home.

Economic policies have included nationalization of much of industry as well as of banking and insurance. Interest-free banking is practiced nationwide, although in actual practice it differs little from standard banking—the differences are largely semantic reshufflings. The Islamic taxes, the *zakat* (wealth tax for the poor), the *'ushr* (tithe), and the *khums* (income tax) are not collected by the state but are voluntarily given to the ulama, thereby reinforcing their power and independence. Furthermore, many confiscated enterprises are owned and run by foundations managed by the ulama. Land reform was carried out in the cities for the purpose of providing housing for the urban poor and homeless. The distribution of income became more equal after the revolution but a trend to greater inequality reemerged later. Rural incomes have improved relative to urban incomes.

After the revolution restrictions were placed on the behavior of women, including dress, labor force participation, and birth control, although the latter issue is being reconsidered by the government because of Iran's high population growth rate.

Iran's currency, the rial, was long fixed in international value, despite being overvalued and despite the accompanying macroeconomic distortions and

imbalances of various sorts, including problems of corruption and rent-seeking. The overvaluation of the rial simply reinforced Iran's dependence on oil exports for hard currency revenues, in contrast with the original goals of the revolution.

Thus Iran is the most prominent model in the world for revolutionary New Traditionalism, the attempted combination of a traditional fundamentalist religion with modern high technology in an economy independent of the patterns of either the old capitalist or socialist economies. It stands in contrast to more moderate models such as Saudi Arabia and Pakistan. But Iran faces a choice between pragmatically reintegrating into the world's economy and polity at large, thus probably achieving a greater rate of growth, or pursuing its role as the leading supporter of Islamic revolutions around the world, thus probably achieving a continuing political isolation and economic stagnation. Very likely the struggle between these competing tendencies will go on for a long time to come.

Questions for Discussion

1. Why is the revolutionary tradition stronger in Shi'i Islam than in Sunni Islam?
2. What have been the characteristics of the four phases of economic policy since the 1979 revolution?
3. What has been the role of the oil industry in the economy both before and after the revolution in Iran?
4. What is the role of the religious foundations in the Iranian economy?
5. Has Iran succeeded in eliminating interest from its banking system? What have been the results of its efforts to do so?
6. How does the Shi'i view of zakat differ from the Sunni view and what are the implications of this for Iran?
7. How have economic policies regarding women changed since the revolution?
8. To what extent does the Iranian economy represent a New Traditional Third Way between capitalism and socialism?
9. Compare the Pakistani model of Islamic economics with that of Iran.
10. In its effort to be a role for Islamic economies in the world, what is a fundamental contradiction Iran faces?

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